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Supreme Court, U.S.
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In the
SUPREME COURT OF THE UNITED STATES
October Term, 1999

EDWARD E. LITWAK, Petitioner,
v.
OSCAR PRODUCTIONS, INC. (f/s/o Jennifer O'Neill)
and JENNIFER O'NEILL, Respondents.

On Petition for a Writ of Certiorari to the
United States Court of Appeals
For the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In nondischargeability proceedings under 11 USC § 523, should the federal rule of collateral estoppel apply to a default judgment entered in a state court proceeding.

2. Does the full faith and credit statute (28 USC §1738) require the bankruptcy court to apply the state rule of collateral estoppel in nondischargeability proceedings, and if so, has 28 USC § 1738 been partially repealed as to true default judgments entered by state courts.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES ..... iii-v

OPINIONS BELOW 1

JURISDICTION 2

STATUTORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE PETITION 5

I. The Grogan Decision Requires Application of The Federal Rule of Collateral Estoppel 6

II. Application of Grogan – The Conflict Among the Court of Appeal 8

A. Courts of Appeal That Apply The Federal Rule 9
B. Courts of Appeal That Apply Marrese 13
C. Implied Repeal of Section 1738 14

III. Applying The Federal Rule of Collateral Estoppel is Required to Comply With The U.S. Constitution 17

CONCLUSION 20

APPENDIX ..... 1-A to 22-A

TABLE OF AUTHORITIES

Cases

Angus v. Wald (In re Wald)
208 BR 516 (Bankr. ND Ala 1997) 9, 16, 18, 19

Bay Area Factors v. Calvert (In re Calvert)
105 F.3d 315 (6th Cir. 1997) 14

Brown v. Felsen
442 US.. 127 (1979). 9, 14, 15, 16

Davis v. Massey (In re Massey)
228 B.R. 686 (Bankr. S.D. Ind. 1998). 12

Garner v. Lehrer (Matter of Garner)
56 F. 3d 677 (5th Cir. 1995). 13

Gayden v. Nourbakhsh (In re Nourbakhsh)
67 F. 3d 798 (9th Cir. 1995) 3, 4, 13, 14, 16

Grogan v. Garner
498 U.S. 279 (1991). 5, 6, 7, 8, 13, 14, 15, 16

Hanover National Bank v. Moyses
186 U.S. 181 (1902) 17

In re Bugna, 33 F. 3d 1054 (9th Cir. 1994) 19

M & M Transmissions, Inc., v. Raynor, (In re Raynor)
922 F. 2d 1146 (4th Cir. 1991). 9, 10

TABLE OF AUTHORITIES (cont'd.)

Marrese v. American Academy of Orthopaedic Surgeons
470 U.S. 373 (1985) 8, 13, 14, 15, 18, 19

Matsushita Electrical Industrial Co., Ltd. v. Epstein
516 U.S. 367 (1996) 9, 14, 15, 16

Matter of McMillan
579 F. 2d 289 (3rd Cir. 1978) 12

Meyer v. Rigdon
36 F. 3d 1375 (7th Cir. 1994) 11, 12

Newsom v. Moore (In re Moore)
186 B.R. 962 (Bankr. ND Cal. 1995). 19

Pahlavi v. Ansari (In re Ansari)
113 F. 3d 17 (4th Cir. 1997). 10, 11

Schaffer v. Dempster (In re Dempster)
182 B.R. 790 (Bankr. N.D. Ill. 1995). 12

Stellwagen v. Clum
245 U.S. 605 (1918) 17

Stokes v. Vierra (In re Vierra)
173 B.R. 417 (Bankr. N.D. Cal. 1994) 18

Constitutional and Federal Statutes

U.S. Constitution - Article 1, § 8 ..... .2, 5, 17

11 USC §523 .. ..2, 3, 4, 10, 11, 12

28 USC §157(b) 3

28 USC §1254(1) 2

28 USC §1738 ..... .2, 5, 9, 13, 14, 15, 16, 18

Other

Restatement(Second)of Judgments
§ 27 (1982) 7, 8, 9, 10, 13

Tisha Morris Federico, 71 Am Bankr. L.J. 563 (1997)
Dischargeability Proceedings and Prepetition Default Judgments: Does the Bankruptcy Code Implicitly Repeal the Full Faith and Credit Requirement of 28 USC §1738? 5, 6

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1999

EDWARD E. LITWAK, PETITIONER,

V.

OSCAR PRODUCTIONS, INC. (f/s/o Jennifer O'Neill) and JENNIFER O'NEILL, Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Edward E. Litwak ("Litwak") respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinions of the court of appeals (App., *infra*, 1-A to 5-A), bankruptcy appellate panel (App., *infra*, 6-A to 14-A), and the bankruptcy court's Judgment and Findings of Fact and Conclusions of Law (App., *infra*, 15-A to 22-A) are unreported.

JURISDICTION

The court of appeals entered its judgment on May 2, 2000 (App., *infra*, 2-A to 5-A). The court of appeals denied a timely petition for rehearing and petition for rehearing en banc on June 12, 2000 (App. *infra*, 1-A). The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254 (1).

STATUTORY PROVISIONS INVOLVED

Article I §8, cl. 4 of the United States Constitution provides, in relevant part, that the power is vested in Congress " to establish ... uniform laws on the subject of bankruptcies throughout the United States."

11 USC Section 523 (c) provides, in relevant part that

> ". . .the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), (6), or (15) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge . . . ."

28 USC §1738 provides, in relevant part, that

> ". . . judicial proceedings ... shall have the same full faith and credit in every court within the United States ... as they have

by law or usage in the courts of such State ... from which they are taken."

STATEMENT OF THE CASE

The jurisdiction of the bankruptcy court was invoked under 28 USC §157 (b) (2) (1), a core proceeding arising under Title 11 [11 USC §523(a)(2)(A) and (a)(6)]. The facts germane to this petition are undisputed.

On March 17,1997, a state court default judgment was entered against Litwak based on fraud and intentional infliction of emotional distress in favor of Respondents, Oscar Productions, Inc. (f/s/o Jennifer O'Neill) and Jennifer O'Neill (collectively "O'Neill"). The amount of the judgment was $6,250,000.00, plus $2,230,559.40 in prejudgment interest, and costs of $182.00, together with interest as provided by law. Litwak had no knowledge that the judgment had been entered until his bank account was attached, more than four years after the Request To Enter Default had been entered.

On November 5,1997, Litwak filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code, seeking to discharge the debt. O'Neill filed an adversary proceeding on January 8, 1998 to determine the non-dischargeability of the debt pursuant to 11 U.S.C. §523 (a) (2)(A) (fraud) and 523(a)(6) (willful and malicious injury).

On May 26,1998, the bankruptcy court granted O'Neill's motion for summary judgment. The Court found that under applicable 9th Circuit law, *Gayden v. Nourbakhsh (In re Nourbakhsh)* 67 F. 3d 798 (9th Cir.

1995) collateral estoppel precluded relitigation of the state court default judgment (App. *infra*, 20-A).

On June 11, 1998, the bankruptcy court entered an order that Litwak's debt to O'Neill was non-dischargeable under 11 U.S.C. §523(a)(2)(A) and (a)(6). Judgment was entered in favor of O'Neill and against Litwak in the amount of $8,480,741.40 (App. *infra*, 15-A).

On June 17,1998, Litwak filed his Notice of Appeal to the 9th Circuit Bankruptcy Appellate Panel ("BAP").

On March 2,1999, the BAP affirmed the bankruptcy court's order. The BAP found that the bankruptcy court correctly held that the default judgment was entitled to collateral estoppel application pursuant to *In re Nourbakhsh, supra* (App. *infra*, 6-A to 14-A).

On March 25,1999, Litwak filed his Notice of Appeal to the Ninth Circuit Court of Appeals.

On May 2, 2000, the Court of Appeals affirmed the bankruptcy court's order. The Court of Appeals held that the issues in this case are the same as presented in *In re Nourbakhsh, supra* and therefore, the Court of Appeals was bound by the *Nourbakhsh* holding unless the case was taken en banc and *Nourbakhsh* was overruled (App. *infra*, 2-A to 5-A).

On May 16, 2000, Litwak filed a Petition For Rehearing And Suggestion for Rehearing En Banc (the "Petition for Rehearing"). On June 12, 2000, Litwak's Petition For Rehearing was denied (App. *infra*, 1-A).

REASONS FOR GRANTING THE PETITION

This case presents an issue of national significance. In *Grogan v. Garner*, 498 U.S. 279, 284-285, *n. 11 (1991), this Court stated that collateral estoppel* principles apply in bankruptcy nondischargeability cases. Grogan did not, however, address whether courts should apply the state or federal rule of collateral estoppel. In federal court, a "true" default judgment will not be given preclusive effect, because it does not meet the "actually litigated," requirement. It is unclear whether courts should apply the state rule of collateral estoppel pursuant to the full faith and credit statute or whether application of the federal rule is consistent with this Court's decision in *Grogan v. Garner, supra.* As a result of this uncertainty, there is a split of authority among the six Courts of Appeal that have addressed the issue.

Moreover, in the circuits that have not addressed the issue, there are conflicting decisions by intra-circuit bankruptcy courts. Debtors within a state are treated differently on the important issue of a right to a discharge, violating the constitution's mandate for "uniform laws on the subject of bankruptcies throughout the United States". Article I §8, cl. 4. This constitutional mandate differentiates this case from other areas of law where 28 USC §1738 compels courts to give full faith and credit to a state court judgment.

This case is timely[1] and guidance from this

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[1] "The differing judicial views regarding the collateral estoppel effect of default judgments in dischargeability proceedings create a dramatic conflict requiring resolution, either by Congress or the Supreme Court."

Court will have an actual, practical effect for courts throughout the United States and for countless litigants.

I.
THE GROGAN DECISION REQUIRES APPLICATION OF THE FEDERAL RULE OF COLLATERAL ESTOPPEL

In *Grogan v. Garner, supra*, a district court jury trial resulted in a fraud judgment in favor of Petitioners. Respondent appealed the trial court's ruling that authorized a verdict based on the preponderance of the evidence. While the appeal was pending, Respondent filed a petition for relief under Chapter 11 of the Bankruptcy Code. After the Court of Appeals affirmed the fraud judgment, Petitioners filed a complaint in the bankruptcy proceeding alleging that the fraud judgment was nondischargeable under §523. The Bankruptcy Court found that all of the elements required to establish actual fraud under §523 had been proved and that the doctrine of collateral estoppel required a holding that the debt was not dischargeable. The Court of Appeals, reversed, holding that the clear and convincing standard applied to non-dischargeability proceedings. *Grogan, supra* at 281-282.

In reversing the Court of Appeals and holding that the preponderance standard applied in

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Tisha Morris Federico, 71 Am. Bankr. LJ., 563, 585 (1997); *Dischargeability Proceedings and Prepetition Default Judgments Does the Bankruptcy Code Implicitly Repeal The Full Faith and Credit Requirement of 28 USC §1738?*

nondischargeability proceedings, this Court held as follows:

> "If the preponderance standard also governs the question of non-dischargeability, a bankruptcy court could properly give collateral estoppel effect to those elements of the claim that are identical to the elements required for discharge and that were actually litigated and determined in the prior action. See Restatement (Second) of Judgments §27 (1982)." (emphasis added) *Grogan, supra* at 284.

Thus, as this Court stated, two conditions must be present before bankruptcy courts can apply collateral estoppel in a nondischargeability proceedings: 1) the elements of the two claims must be identical; and 2) the elements were "actually litigated" and determined in the prior action. The dispute that has arisen, is whether a default judgment satisfies the "actually litigated" condition. This Court's citation to Restatement (Second) of Judgments §27 (1982), however, defined when a claim is "actually litigated." The Restatement's discussion of issues not actually litigated includes the following:

> "A judgment is not conclusive in a subsequent action as to issues which might have been but were not litigated and determined in the prior action. There are many reasons why a party may

> choose not to raise an issue, or to contest an assertion, in a particular action.
>
> . . . .
>
> In the case of a judgment entered by confession, consent, or default, none of the issues is actually litigated. Therefore, the rule of this Section does not apply with respect to any issue in a subsequent action. (emphasis added) Restatement (Second) of Judgments §27 pp 256-257 (1982).

Furthermore, this Court stated, and re-stated, that nondischargeability is a matter of federal law. "Since 1970, however, the issue of nondischargeability has been a matter of federal law governed by the terms of the Bankruptcy Code. " *Grogan, supra* at 284. Congress amended the Bankruptcy Act in 1970 to make nondischargeability a question of federal law independent of the issue of the validity of the underlying claim."' *Grogan, supra* at 289.

II.
APPLICATION OF GROGAN - THE CONFLICT AMONG THE COURT OF APPEALS

The Appellate Courts that have applied Grogan to determine whether a bankruptcy court should give collateral estoppel effect to a state court default judgment, adopt either the federal rule or the analytical framework set forth in *Marrese v. American Academy of Orthopaedic Surgeons,* 470 U.S. 373 (1985).

Under the federal rule of collateral estoppel, the issues sought to be precluded must have been actually

litigated in the prior proceeding as defined by the Restatement (Second) of Judgments §27 (1982). Most of these cases hold that *Brown v. Felsen*, 442 U.S. 127 (1979) requires bankruptcy courts to apply federal law to determine the collateral estoppel effect of a state court judgment. *Angus v. Wald (In re Wald)* 208 B.R. 516, 520 (Bkrtcy. N.D. Ala. 1997).

Courts that follow the Marrese approach, apply a two-part test:

1. First, the preclusive effect of plaintiffs' state court default judgment under state collateral estoppel law in which the judgment was rendered.

2. Second, if the judgment would have preclusive effect under the applicable state law, the full faith credit statute of 28 U.S.C. §1738 requires recognition of that result, unless as an exception to §1738, the Court should refuse to give preclusive effect to the state court judgment. *Matsushita Electric Industrial Co. Ltd. v. Epstein*, 516 U.S. 367, 375 (1996).

The Third, Fourth and Seventh Circuit Courts of Appeal hold that a default judgment does not satisfy the "actual litigation" requirement to invoke collateral estoppel.

A. Courts of Appeal That Apply The Federal Rule

In *M & M Transmissions, Inc v. Raynor, (In re Raynor)*, 922 F.2d 1146 (4th Cir. 1991), the court held that an indispensable requirement of collateral estoppel is actual litigation of the issue. In the Fourth Circuit, " [t] o preclude a debtor from litigating an issue dispositive of discharge, the record of the case giving rise to the judgment debt must show that the issue was

actually litigated .... *Id.* at 1149. Citing the Restatement (Second) Judgments §27 comment e, the court concluded that a state court default judgment cannot support issue preclusion. *Id.* at 1150. Accordingly, the basis for the court's decision was that the federal, not the state rule of collateral estoppel applied.

In *Pahlavi v. Ansari (In re Ansari),* 113 F. 3d 17 (4th Cir. 1997) a state court entered a default judgment against Ansari for fraud and breach of fiduciary duty after it found that Ansari had willfully disregarded multiple discovery orders. *Id* at 18. Subsequently, Ansari filed Chapter 7 and the bankruptcy court granted Pahlavi's motion for summary judgment for nondischargeability (11 USC §523 (a) (4) based on collateral estoppel. Ansari argued that the default judgment did not meet the "actually litigated" requirement.

The *Ansari* court applied *Marrese* and determined that under Virginia law, Ansari's conduct and participation in the litigation met the actually litigated standard. Prior to the default, multiple depositions were taken, documents exchanged, and hearings held. *Id.* at 21 With respect to punitive damages, the court held a two-day hearing in which Pahlavi and Ansari, and other witnesses testified. *Id.* at 21.

The court stated, however, that the holding in *Ansari* is not contrary to its holding in *In re Raynor, Id.* at 21. First, Virginia law governed *Ansari* and North Carolina law controlled in *Raynor.* The court went on to state, however, that:

> . . . even if Virginia law had been applicable in *Raynor* it is not at all clear

> that the result there would have been different. This is so because in *Raynor*, unlike the case at hand, the parties engaged in literally *no* litigation on the issue of fraud." (emphasis original) *Id.* at 21.

Lastly, the court noted that the policy concerns expressed by the Fifth, Eleventh, and Ninth Circuits that a default judgment entered for discovery violations can act as collateral estoppel in a later case, justified application of collateral estoppel. *Id.* at 22.

The Seventh Circuit has also held that

> "...a default judgment is normally not given preclusive effect under collateral estoppel doctrine because no issue has been 'actually litigated.' " (citation omitted) *Meyer v. Rigdon* 36 F. 3d 1375, 1379 (7th Cir. 1994).

Although Meyer involved a judgment granted by a federal district court, the court recognized that default judgments are not given preclusive effect in dischargeability actions.

In Meyer, the court considered whether a default judgment for breach of fiduciary duty obtained in a federal district court against a bank's board of directors was nondischargeable under §523 (a) (11). *Id.* at 1378. Under that section, any final judgment for fraud or defalcation in a fiduciary capacity committed against a depository institution is nondischargeable. The court held that Congress, in enacting §523 (a) (11), preempted the common law principles of collateral estoppel. *Id.* at

1380. Therefore, under that section, the bankruptcy court is required to "give preclusive effect to dispositions, like default judgments . . ., that would not be given preclusive effect under the common law." *Id.* at 1380. Accordingly, the court believed that Congress, in passing §523 (a) (11), recognized that default judgments are not given preclusive effect in dischargeability actions. The court noted that §523 (a) (11) would be superfluous if it did not apply to default judgments because it would then have the same effect as section 523 (a) (4). *Id.* at 1380. Moreover, a bankruptcy court within the Seventh Circuit relied on *Meyer* in its decision to deny collateral estoppel effect to a state court default judgment. *Schaffer v Dempster (In re Dempster)*, 182 B.R. 790, (Bankr. N.D. Ill. 1995). ["As a matter of well-settled law, default judgments are not ordinarily given preclusive effect in subsequent court proceedings because no issue was 'actually litigated' in the earlier proceeding."] *Id.* at 799. Similarly, in *Davis v. Massey (In re Massey)* 228 B.R. 686 (Bankr. S.D. Ind. 1998), the Court held that

> "Almost all courts hold that where there is a 'true default', i.e., the debtor made no appearance whatsoever in the prior proceeding, collateral estoppel should not be applied." *Id.* at 690.

Although a pre *Grogan* case, in the Third Circuit, *Matter of McMillan*, 579 F. 2d 289 (3rd Cir. 1978) still stands for the proposition that collateral estoppel does not apply to a default judgment because it is not actually litigated.

"...because the bankrupts did not 'actually litigate' the Ocean County case, not even facts which were necessary to that judgment can collaterally estop them from relitigating the same issues in the bankruptcy case. This holding is consistent both with the general rules of collateral estoppel and with the federal policies in bankruptcy cases." *Id.* at 292.

B. Courts Of Appeal That Apply Marrese

The *Nourbakhsh* opinion is in general accord with the Fifth and Sixth Circuits. In *Garner v. Lehrer (Matter of Garner)* 56 F. 3d 677 (5th Cir. 1995), the court applied the *Marrese* analysis to conclude that under Texas law, collateral estoppel bars relitigation of a state court default judgment for fraud in a subsequent nondischargeability proceeding. *Id.* at 679-680. Although the *Garner* court found that there is not an implied repeal of §1738 in the context of a nondischargeability proceeding (*Id.* at 681), *Garner* did not involve a "true default judgment." The defendant had answered the complaint and a trial ensued in which plaintiff " . . . put on evidence sufficient to carry his burden of proof. *Id.* at 680. The judgment was described as a " ' post-answer 'default' judgment. (citation omitted) *Id.* at 680.

Of importance, however, is the fact the court cited Restatement (Second) of Judgments §27 cmt. d (1982) as authority for the proposition that: ("when an issue is properly raised, by the pleadings or otherwise, and is submitted for determination and is determined, the issue is actually litigated."). *Id.* at 680. The

Restatement also provides, however, that true default judgments do not meet the "actually litigated" requirement. Restatement, supra, §27 at 256-257.

In the Sixth Circuit, *Bay Area Factors v Calvert (In re Calvert)*,105 F. 3d 315 (6th Cir. 1997) relied on *Marrese* to hold that California law gives preclusive effect to default judgments. *Id.* at 318. Applying the second prong of *Marrese*, the court held that neither the Bankruptcy Code nor legislative history suggests that Congress intended an exception to §1738 for true default judgments. *Id.* at 322.

The Ninth Circuit concluded that since *Grogan* held that collateral estoppel principles apply in discharge exception proceedings, then *a fortiori*, there is no exception to the full faith and credit statute. *Nourbakhsh, supra* at 801. *Calvert*, however, rejected the Ninth Circuit's reliance on *Grogan*, pointing out that the Supreme Court " . . . did not decide the narrower question of whether collateral estoppel also applies to default judgments." *Id.* at 318. As discussed above, the Grogan court did not address §1738, and therefore, did not discuss whether there was an exception to the full faith and credit statute.

C. Implied Repeal to §1738

Assuming the default judgment would be given preclusive effect under the second prong of *Mareese*, the framework requires a determination of whether there has been a partial repeal of §1738. Where there is no express repeal, any modification of §1738 must be implied. *Matsushita, supra* at 881. In deciding whether there is an implied repeal to §1738, the

"... general question is whether the concerns underlying a particular grant of exclusive jurisdiction justify a finding of an implied partial repeal of §1738. Resolution of this question will depend on the particular federal statute as well as the nature of the claim or issue involved in the subsequent federal action.... The primary consideration must be the intent of Congress." *Marrese, supra* at 386.

In *Brown, supra*, this Court specifically recognized that the 1970 amendments to §17 now (§523) embodied the intent of Congress that state judgments would not have claim preclusion effect on dischargeability issues in bankruptcy. *Brown , supra* at 135-136. This Court has reaffirmed this holding in *Matsushita, supra.*

"As a historical matter, we have seldom, if ever, held that a federal statute impliedly repealed §1738. [citations omitted] The rarity with which we have discovered implied repeals is due to the relatively stringent standard for such findings, namely, that there be an "'irreconcilable conflict'" between the two federal statutes at issue. [citation omitted] But cf. *Brown v. Felson*, 442 U.S. 127, 138-139, 99 S. Ct. 2205, 2212-2213, 60 L. Ed. 2d 767 (1979) (declining to give claim preclusive effect to prior state court debt collection proceeding in federal bankruptcy suit, without discussing

§1738, state law or implied repeals). "*Id.* at 380- 381.

The Brown holding provides a basis for the argument that congress implicitly repealed the full faith and credit statute in the context of applying claim preclusion or issue preclusion to state court default judgments in certain dischargeability proceedings. This congressional grant of exclusive bankruptcy jurisdiction, coupled with the articulated Congressional policy to provide a fresh start for the honest, but unfortunate debtor, presents an "irreconcilable conflict" with the application of the full faith and credit statute to state court default judgments. No Supreme Court decision has questioned the continuing viability of *Brown* including this Court's decision in *Grogan.* In *Nourbakhsh, supra,* the Court's conclusion that *Brown* was a res judicata case, and therefore, is not an exception to §1738 when the issue is collateral estoppel fails to recognize the semblance. Applying collateral principles to a true default is, in effect, the same as applying res judicata.

> "...the principles and considerations which led to the Supreme Court's decision in *Brown* also mandate a similar exception in the area of collateral estoppel when nothing was actually litigated by the state court tribunal." *In re Wald, supra* at 551

III.
APPLYING THE FEDERAL RULE OF COLLATERAL ESTOPPEL IS REQUIRED TO COMPLY WITH THE U.S. CONSTITUTION

Article 1, §8, cl. 4 of the United States Constitution provides that the power is vested in Congress "to establish ... uniform laws on the subject of bankruptcies throughout the United States." This Court has discussed the constitutionality of state laws affecting bankruptcy.

In *Hanover National Bank v Moyses*, 186 U.S. 181 (1902) the court addressed whether application of state exemption laws to a bankrupt violated the constitutional provision for uniform laws on the subject of bankruptcies throughout the United States. The court held that the required uniformity is geographical and not personal. *Id.* at 188. The court went on to hold that in a constitutional sense, the system is uniform throughout the United States, because the property the trustee takes in each state is the same as would have been available to creditors absent the bankruptcy laws. "The general operation of the law is uniform although it may result in certain particulars differently in different states." *Id.* at 190.

Similarly, in *Stellwagen v. Clum*, 245 U.S. 605 (1918), the court held that congress may recognize

> ". . . the laws of the several states affecting dower, exemptions, the validity of mortgages, priorities of payment and the like. Such recognition in the application of state laws does not affect the constitutionality of the Bankruptcy Act,

> although in these particulars the preparation of the act is not alike in all the States." *Id.* at 613.

Application, however, of the full faith and credit statute, requiring bankruptcy courts to apply the state law of collateral estoppel leads to inconsistent results within a state. This inconsistency violates the Constitution's mandate for uniform laws on the subject of bankruptcies.

In re Wald, supra, contains a collection of cases where lower state appellate courts are in conflict as to whether collateral estoppel applies to a default judgment. The *Wald* court noted that "[v]ery few state appellate courts and fewer state courts of last resort have clearly decided the issue." *Id.* at 537. Thus, it is a difficult or impossible task for bankruptcy courts to discern whether a default judgment satisfies the "actual litigation" requirement. *Id.* at 539 n. 26. "The problem is real when consideration is given to the fact that courts of the same district often adopt conflicting interpretations of the same state laws." *Id.* at 549. [See, *Stokes v. Vierra (In re Vierra),* 173 B.R. 417 (Bankr. N.D. Cal. 1994) - the district court disagreed with the bankruptcy court's determination that under South Carolina law, a default judgment must be accorded collateral estoppel effect.]

Even in California, the issue is not crystal clear.

> "While the question is a close one and the California authorities are less than clear, the court believes that Fitzgerald has not been disapproved and ...a California court would apply California law to bind

> Defendant as to the matters necessarily decided that resulted in the Default Judgment. *Newsom v. Moore (In re Moore),* 186 B.R. 962,971 (Bankr. N.D. Cal. 1995)' " *Wald, supra,* at 539 n. 26.

The only way to ensure the application of uniform bankruptcy laws within a state is to apply the federal rule of collateral estoppel. Chief Justice Burger, in his concurring opinion in *Marrese* recognized that state law may be indeterminate on a claim or issue preclusion subject; and therefore

> " . . . it may be consistent with §1738 for a federal court to formulate a federal rule to resolve the matter . . . . Given the insubstantiality of the state interests and the weight of the federal interests, a strong argument could be made that a federal rule would be more appropriate than a creative interpretation of ambiguous state law." *Marrese, supra,* 470 U.S. at 390.

Accordingly, application of the federal rule of issue preclusion is consistent with the principles set forth in Brown; it is consistent with Grogan; it ensures compliance with the U.S. Constitution; and it does not offend the principle of collateral estoppel - " . . . to relieve parties of the cost and vexation of multiple lawsuits and [conservation of] judicial resources." *In re Bugna,* 33 F. 3d 1054,1056 (9th Cir. 1994).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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